DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 06-0419; 06-0510
GROSS RETAIL TAX
For the Years 2004 and 2005

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ISSUE

I. **Aircraft Purchase** – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-1 to 40; IC § 6-2.5-5-8; IC § 6-2.5-5-27; IC § 6-8.1-5-1(b); *Carnahan Grain, Inc. v. Department of State Revenue*, 828 N.E.2d 465 (Ind. Tax Ct. 2005); *Panhandle Eastern Pipeline Co. v. Indiana Department of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001); *Indiana Department of State Revenue v. Indiana Belt Railroad Co.* 460 N.E.2d 171 (Ind. Ct. App. 3 Dist. 1984); 45 IAC 2.2-5-15; 45 IAC 2.2-5-15(a); 45 IAC 2.2-5-15(b)(2); IAC 2.2-5-61(b).

Taxpayers argue that they were not required to pay gross retail (sales) tax when they purchased an aircraft because the aircraft was purchased in order to rent or lease it to others during the regular course of taxpayers' business. Alternatively, taxpayers argue that the purchase was exempt because the aircraft is being used to provide public transportation services.

STATEMENT OF FACTS

In 2004, four Limited Liability Companies purchased an aircraft for $1,000,000. On the "Application for Aircraft Registration or Exemption," the owners claimed that the "Aircraft was purchased by registered retail merchant[s] for . . . "Rental or Lease to others per IC 1971-6-2.5-5-8."

Thereafter the four Limited Liability Companies entered into "Aircraft Rental Agreement[s]" on January 2, 2005. The four Limited Liability Companies rented the aircraft to Management Company. The Agreement states that the taxpayer[s] "hereby rents to [Management Company] the non-exclusive right to use and operate a certain aircraft . . . which is owned and titled in the name of [taxpayer]. [Management Company] is renting aircraft for the purpose of transporting [taxpayer] or its members, directors, officers, employees and guests in furtherance of its primary, non-transportation business and its employee benefits."

The Agreement states that the Management Company is required to "schedule its desired flight time (and Aircraft return time) in advance with [Taxpayer]. The Aircraft shall be available to

[Management Company] when not previously scheduled by [taxpayer] or any other Operator or is otherwise available, such as due to maintenance."

The Agreement provides that "[Management Company] shall pay [taxpayer] base rent . . . for use of the Aircraft."

The Agreement is a two-way street. The Limited Liability Companies – including the taxpayers - rented the aircraft to Management Company, but the taxpayers retained a priority right to use the aircraft for the taxpayers' own purposes. The Management Company had the right to use the aircraft whenever the taxpayers did not need the aircraft for their own use; in return, the Management Company paid rent to the taxpayers.

The Indiana Department of Revenue (Department) reviewed the relevant documentation, disallowed the claim for rental exemption, and billed each of the four Limited Liability Companies for the amount of sales tax that the Department determined should have been paid at the time the aircraft was purchased.

Two of the Limited Liability Companies (hereinafter "Taxpayers") challenged the proposed assessment of sales tax, the matter was assigned to a Hearing Officer, an administrative hearing was conducted during which the Taxpayers explained the basis for their protest, and this Letter of Findings results.

I. **Aircraft Purchase** – Gross Retail Tax.

DISCUSSION

Taxpayers argue that the Department erred in rejecting its assertion that the aircraft was purchased for an exempt purpose.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC § 6-2.5-2-1. The legislature has provided a number of exemptions to the imposition of that tax. *See* IC § 6-2.5-5-1 to -40. One of those exemptions is provided at IC § 6-2.5-5-8 which states that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property."

Therefore, if taxpayers bought the aircraft for the purpose of leasing it to others, taxpayers were not required to pay sales tax on the initial purchase price because taxpayers bought the plane for "an exempt purpose."

Management Company operates and maintains the aircraft on behalf of taxpayers. Taxpayers – along with the two remaining Limited Liability shared owners not party to this protest – have first priority on the use of the aircraft. As set out in the agreement, "The Aircraft shall be available to [Management Company] when not previously scheduled by [taxpayer]." In return, the Management Company pays the taxpayers "Aggregate Rentals" for use of the unreserved portion of the aircraft's availability.

The rental exemption set out in IC § 6-2.5-5-8 is further explained in 45 IAC 2.2-5-15, which states:

> (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
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> (b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:
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> > (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;
> > (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
> > (3) The property is resold, rented or leased in the same form in which it was purchased.

The Department is unable to agree that taxpayers have met their burden of proof set out in IC § 6-8.1-5-1(b) necessary for the taxpayers to establish that the purchase of the aircraft was not subject to sales tax on the ground that taxpayers purchased the aircraft for the purpose of renting it to other persons. Under the terms of the 2005 "Aircraft Rental Agreement," the Management Company pays the taxpayer/owners a rental fee for the Management Company's use of the aircraft but – as the Agreement states – "Management Company" is renting Aircraft for the purpose of transporting [Taxpayer(s)] or its members, directors, officers, employees and guests in furtherance of its primary, non-transportation business and its employee benefits." Taxpayers did not acquire the aircraft for "purpose of reselling, renting, or leasing in the regular course of the purchaser's business . . . ." 45 IAC 2.2-5-15(a). Taxpayers jointly purchased an aircraft because they wanted or needed it for their own "non-transportation business." The agreement between taxpayers and the Management Company is simply the means by which the taxpayers chose to manage their joint responsibility for the aircraft, and assure the aircraft was available when the taxpayers needed it.

Taxpayers are simply not "occupationally engaged in reselling, renting or leasing . . . property in the regular course of [their] business . . . ." 45 IAC 2.2-5-15(b)(2).

However, Indiana law allows a sales tax exemption for tangible personal property acquired and used in "public transportation." IC § 6-2.5-5-27 states that, "Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property."

The Department has promulgated a regulation, 45 IAC 2.2-5-61(b), relevant to taxpayers' circumstances. The regulation states:

> Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.

The parties' 2005 "Aircraft Rental Agreement" gives the four owners – taxpayers and the two remaining Limited Liability Companies – priority use of the aircraft. However, the Management Company also rents the aircraft to unrelated, third parties. The third parties enter into individual agreements with the Management Company for use of the aircraft. Management Company thereafter prepares the aircraft, arranges for a pilot, schedules the flight for the third party, and bills the third parties for the cost of the flight. It is this secondary relationship – based upon the Management Company's arrangement with the individual third parties – on which the taxpayers predicate their exemption claim.

The Indiana Tax Court has held that the transportation exemption may not be used to prorate a taxpayer's liability. *Panhandle Eastern Pipeline Co. v. Indiana Department of State Revenue*, 741 N.E.2d 816, 818-19 (Ind. Tax Ct. 2001). Rather, the court has held that the transportation exemption "is an all or nothing exemption." *Id*. at 819. "If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption." *Id*.

In *Carnahan Grain, Inc. v. Department of State Revenue*, 828 N.E.2d 465 (Ind. Tax Ct. 2005), the Tax Court rejected the Department's argument that, although the particular equipment at issue was primarily used to haul products belonging to third-parties, the petitioner was not entitled to claim the exemption on the ground "that Carnahan [was] not entitled to the public transportation exemption because it [was] not, *as a business*, predominately engaged in transporting property for third parties." *Id*. at 467. Instead, the court found that "if a taxpayer's property is predominantly used for hauling third-party property, the taxpayer is entitled to a 100 [percent] exemption despite the fact that the property is also used for non-exempt purposes." *Id*. at 468 citing *Panhandle*, 741 N.E.2d at 819.

However, the statute is specific as to the claim raised by taxpayers. "Transactions involving tangible personal property and services are exempt from the state gross retail tax, *if the person acquiring the property or service directly uses or consumes it in providing public transportation* for persons or property." IC § 6-2.5-5-27 (*Emphasis added*). The aircraft was purchased by the four Limited Liability Companies – including the two taxpayers – but the four Limited Liability Companies did not buy the aircraft to get into the public transportation business. As explained by the parties' own Agreement, taxpayers bought the aircraft "for the purpose of transporting

[Taxpayer(s)] or its members, directors, officers, employees and guests in furtherance of its primary, non-transportation business and its employee benefits." In this case, the Management Company is providing certain public transportation services to the third parties, but the Management Company did not buy the aircraft. Taxpayers bought the aircraft and the taxpayers did not acquire nor do the taxpayers use the aircraft for the purpose of providing public transportation.

The plain language of IC § 6-2.5-5-27 precludes taxpayers from claiming the public transportation exemption. As explained by the court in *Indiana Department of State Revenue v. Indiana Belt Railroad Co.* 460 N.E.2d 171, 174-75 (Ind. Ct. App. 3 Dist. 1984), the public transportation exemption is to be "strictly construed against the taxpayer."

Taxpayers are not entitled to claim the rental exemption. Taxpayers are not entitled to claim the public transportation exemption. The Department's assessment of sales tax on the initial purchase of the aircraft was correct.

FINDING

Taxpayers protest is respectfully denied.

DK/JR/BK – April 18, 2007.